

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GIFTS BY GALLEG0, INC.	:	DETERMINATION
AND THOMAS PADAVONA, AS OFFICER	:	DTA NO. 810018
	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the period December 1, 1985	:	
through November 30, 1988.	:	

Petitioners Gifts By Gallego, Inc. and Thomas Padavona, as officer, 175-41 Liberty Avenue, Jamaica, New York 11433 filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1985 through November 30, 1988.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 18, 1992, at 1:15 P.M., with additional documentary submission and response thereto to have been provided by July 17, 1992. Petitioner appeared by David Feinblum, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Patricia Brumbaugh, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined additional sales and use taxes due from petitioners for the period December 1, 1985 through November 30, 1988.

FINDINGS OF FACT

On November 8, 1989, the Division of Taxation ("Division") issued to Gifts by Gallego, Inc. ("Gifts") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1985 through November 30, 1988. Said notice stated a total tax due of \$66,365.82, penalty of \$18,604.77 and interest of \$22,098.30 for a total amount due of \$107,068.89. On the same date, a second Notice of Determination and Demand for Payment of

Sales and Use Taxes Due was issued to Gifts for the period December 1, 1985 through November 30, 1988, setting forth penalty due in the sum of \$6,636.61. Both notices indicated that the tax assessed thereon had been estimated in accordance with the provisions of Tax Law § 1138(a)(1).

Also on November 8, 1989, two notices of determination and demands for payment of sales and use taxes due were issued to Thomas Padavona, as officer of Gifts by Gallego, Inc., for the same periods applicable to the corporation. The first notice indicated a total tax due of \$66,365.82, penalty of \$18,604.77 and interest of \$22,098.30, for a total amount due of \$107,068.89. The second notice set forth penalty due of \$6,636.61 for the same period. Once again there was an explanation on both notices indicating that the tax assessed had been estimated in accordance with the provisions of Tax Law § 1138(a)(1).

On or about October 19, 1988, the Division began an audit of the business of Gifts, a manufacturer of furniture made from PVC tubing which was cut and glued together and covered with material. The business was located at 175-41 Liberty Avenue, Jamaica, New York.

On October 20, 1988, the Division sent Gifts an appointment letter indicating that Gifts' sales and use tax returns for the period September 1, 1985 through August 31, 1988, had been scheduled for a field audit on November 22, 1988.

The letter went on to state that all books and records pertaining to Gifts' sales tax liability for the period under audit should be available on November 22, 1988, including "journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns and exemption certificates." The letter also stated that Gifts might be required to furnish additional records and/or information during the course of the audit.

Attached to said letter was a "records requested for sales tax audit" checklist, which requested records for the audit period September 1, 1985 to August 31, 1987. This checklist specifically called for Federal income tax returns for "the past two years," sales, purchase and expense invoices for the year 1987, and guest checks and register tapes for the year 1987. Item "11" on the checklist indicated that additional information might be required. Resale

certificates supporting nontaxable sales also were specifically requested on this attached sheet.

An entry in the auditor's log, dated December 27, 1988, indicated that the audit period had been adjusted to the period December 1, 1985 through November 30, 1988. Apparently, a delay in the first appointment date of over one month prevented an audit of the period commencing September 1, 1985 and the audit period was extended one month as a balance. However, there was no evidence that a request for books and records was ever made, either written or oral, for the period September 1, 1988 through November 30, 1988.

The auditor made a survey of the business premises on November 1, 1988, the survey indicated a large warehouse which housed other businesses as well as Gifts. The businesses besides Gifts listed on the door included "World of Cellini", "Money Promotions, Inc.", and "Customize Cushions Corp.". The relationship between these companies and to petitioners was not disclosed.

The premises housed a manufacturing operation and a showroom area surrounded by offices.

An audit was finally performed at petitioners' accountant's office on December 27, 1988. The auditor was presented with a box of materials. Federal tax returns for the fiscal years ended April 30, 1985 and 1986 were produced but no return for 1987 was ever produced. Petitioners produced an accounts receivable worksheet for the period December 1985 through August 1987 and a worksheet containing purchases for the period December 1985 through May 1988. Petitioners also produced some purchase invoices for PVC material used in the production of furniture and some sales invoices issued to major shops selling retail to the public. Resale certificates for these specific invoices were on file. It was generally found on audit that these particular items agreed with sales scheduled. However, when a comparison of the sales and purchases recorded was made to the Federal returns a large discrepancy was indicated. Sales reported as reflected on petitioners' worksheets indicated \$185,979.00 as opposed to the Federal income tax return which reported \$498,798.00 in sales. Purchases recorded as reflected by petitioners' worksheets indicated \$88,930.00 as compared to the Federal income tax returns

which reported purchases of \$364,366.00. When petitioners' accountant was asked to explain the discrepancy, he did so in a letter dated December 21, 1989, which set forth the following:

"My records and those of my client indicate that the Total Sales amounts as reported on the Sales Tax Returns were in fact estimates. Estimates were used as a result of incomplete records being available at the time of filing. These estimates were based on cash receipts and therefore did not take into account either timing differences, or items that were not in fact sales. As my client's business operation consists of manufacturing and sale for resale of PVC furniture and therefore does not involve any taxable sales, the decision was made to file Sales Tax Returns based on the estimates rather than not filing or filing late. You, yourself, have mentioned to me that your visit to my client's place of business indicated that there were was [sic] no indication of any retail (taxable) sales operation taking place."

Based upon this information, the auditor decided to assess based upon petitioner's bank deposit information,¹ since bank deposits were the only item for which petitioner had proof (original source documentation). The Division deemed all deposits nontaxable sales. The auditor took the two available Federal tax returns and used the sales figures thereon as gross sales and subtracted the bank deposits as nontaxable sales yielding taxable sales figures. He divided the figure by two to get an average year and multiplied by three for the audit period. For the period December 1, 1985 through November 30, 1988, taxable sales were deemed to be \$804,435.00 yielding additional tax due of \$66,365.89. Penalty and interest were also assessed and omnibus penalty was assessed due to the fact that there was an omission of additional tax greater than 25% of audited tax due.

Petitioner's representative, Mr. David Feinblum, C.P.A., testified at hearing that he was unable to produce invoices of purchases or sales at the time of the audit and that there was confusion with regard to sales figures set forth on sales tax returns filed for the period in issue. Mr. Feinblum did not have records available at formal hearing, but was given an opportunity to submit documentation after the hearing to explain the large discrepancy between sales and purchases as recorded on petitioner's worksheets and those reflected on the Federal income tax returns for the years ended April 30, 1985 and 1986. Petitioner submitted partial sets of

¹The bank statements were in the name of Gifts by Gallego, Inc., Manufacturer's Hanover Trust Company Account No. 153 0613051 65.

invoices for the fiscal year ended April 30, 1986 and for the period May 1,

1986 to November 30, 1988. It is noted that the sales invoices were not from Gifts By Gallego, Inc. but rather from an entity known as Cellini PVC located at 175-41 Liberty Avenue, Jamaica, New York, the same address listed for petitioner. Additionally, the more recent invoices note that Cellini PVC is a "subsidiary of Gifts By Gallego, Inc." However, no evidence was submitted to explain the relationship between the entities.

Other evidence submitted by petitioner post hearing included adding machine tapes which totalled the attached sales invoices for the fiscal year ended April 30, 1986. The totals were more than \$100,000.00 less than sales reported on the Federal income tax return for the same period. Similarly, the purchase invoices submitted by petitioner for the same period (indicating purchases by Cellini PVC, not petitioner) totalled \$302,855.67, while the Federal return for the same period reported \$348,938.00 for cost of goods sold.

There is no evidence in the record with regard to the corporate structure of Gifts By Gallego, Inc., or its relationship with any other corporation with which it might have had a sales or marketing relationship. There was no explanation as to how the goods were transferred to "subsidiary" corporations, if in fact that was the method by which Gifts marketed its product. Further, there was no evidence offered with regard to how other related corporations might have reported their sales, or whether separate bank accounts were utilized by those corporations. Additionally, no additional resale certificates were produced after hearing.

CONCLUSIONS OF LAW

A. There was no question that petitioner's records in the instant matter were inadequate to permit an exact computation of the sales and use taxes due, and that the Division was authorized herein to estimate the tax liability on the basis of external indices. In fact, petitioner conceded the inadequacy of its records at the time it filed its returns, on audit, at hearing and after hearing (Tax Law § 1138[a][1]; *see, Matter of Restaurante Puglia, Ltd. v. Chu*, 102 AD2d 348, 478 NYS2d 91, 93; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d

858, 446 NYS2d 451, 452). It is settled that the audit methodology selected must be reasonably calculated to reflect the taxes due (Matter of Restaurante Puglia, Ltd. v. Chu, *supra*; Matter of W. T. Grant, Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, *cert denied* 355 US 869), but exactness is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, *affd* 44 NY2d 684, 405 NYS2d 454; Matter of Lefkowitz, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was reasonable or that the amount assessed was erroneous (Matter of Meskouris Brothers v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, *supra*). Historically, considerable latitude has been given to the auditor in his method of estimating sales in such circumstances as those that exist herein (Matter of Grecian Square v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221), and petitioner bears the burden to prove the audit methodology unreasonable (Matter of Surface Line Operators Fraternal Org. v. Tully, *supra*). However, the record must contain sufficient evidence to allow the trier of fact to determine whether the audit has a rational basis (Matter of Grecian Square v. New York State Tax Commn., *supra*, 501 NYS2d at 221; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989).

In the present matter, the Division used the only source documentation presented to it to account for receipts of petitioner, i.e., its bank deposit records. It generously gave petitioners full credit for these deposits as nontaxable sales even though petitioners could not establish this through the corporation's records. However, to the extent Gifts was not able to specifically account for the discrepancy between the amount of sales allowed per deposits and the sales stated on its Federal income tax returns, it was assessed additional tax thereon. Petitioners' submission of further documentation after the hearing also did not satisfactorily explain the discrepancy.

Petitioners conceded poor recordkeeping practices, admitting to using gross estimates on sales and use tax returns during the audit period. They believed that, since all sales of a manufacturer would be tax exempt, the numbers did not matter. However, when that sloppiness

translated into an inability to justify and explain gross sales and purchases as set forth on Federal income tax returns, it gave the Division no choice but to estimate its tax liability.

Unlike the situation in cases such as Matter of On the Rox Liquors, Ltd. v. State Tax Commn (124 AD2d 402, 507 NYS2d 503, lv denied 69 NY2d 603, 512 NYS2d 1026) and Matter of Bernstein-On-Essex St. (Tax Appeals Tribunal, December 3, 1992), the Division did not merely deny all nontaxable sales due to a failure of petitioners to come forward with documentation confirming their existence and accuracy (even though Tax Law § 1132[c] presumes all sales taxable until the contrary is established). In this case, the Division was very fair with petitioners, recognizing that Gifts was a manufacturer and observing that some resale certificates were available. It was apparent that some nontaxable sales were made and an allowance was made therefor. However, the Division properly taxed those sales which appeared from the discrepancy between gross sales as listed on the Federal income tax returns and those nontaxable sales evidenced by bank deposits.

For all of these reasons, it is determined that the Division's audit methodology was proper and reasonably calculated to reflect the taxes due.

B. The Division did not clearly request books and records for the last quarter of the audit period, September 1, 1988 through November 30, 1988. It is well settled that where a taxpayer has maintained adequate books and records, the auditor cannot ignore them and instead rely on external indices (Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109). The fact that petitioner may have been aware that the audit period had been extended does not function as a request for books and records for the extended period (Matter of Top Shelf Deli, Tax Appeals Tribunal, February 6, 1992).

Therefore, the assessment for the quarter ended November 30, 1988 is cancelled.

C. The petition of Gifts By Gallego, Inc. and Thomas Padavona, as officer, is granted to the extent set forth in Conclusion of Law "B", but in all other respects is denied, and the four notices of determination and demands for payment of sales and use taxes due dated

November 8, 1989 are sustained.

DATED: Troy, New York
February 18, 1993

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE